issuance of this NPRM, there should come mandatory and more abbreviated transition periods.

Additional transition requirements are also necessary. Foreign carriers from all countries should begin an immediate transition toward implementation of the new benchmarks and reduce their settlement rates by equal proportionate annual amounts throughout the transition period. The failure by U.S. carriers to achieve these interim steps in their negotiations with foreign carriers should permit the Commission to prescribe rates at the benchmark level on complaint by a U.S. carrier. Moreover, the Commission should ensure that footdragging further is discouraged by prescribing the payment of benchmark rates by U.S. carriers in response to complaints concerning the failure to observe transition rates, and by prescribing rates lower than the top end of the benchmark ranges in response to complaints that benchmark rates have not been met.

There is certainly no justification for the additional transition periods the NPRM (¶ 67) suggests for carriers in countries that would lose more than a certain percentage either of their settlement rate or of their annual revenue in moving to the new benchmarks. The beneficiaries of any such measure would be the very carriers that have been most resistant to reducing their accounting rates to comply with Commission and ITU policies. To reward such recalcitrance would merely provide an incentive for further non-compliance. The only exception from these transition periods should rather be for temporary emergencies (war, famine, or natural disasters).

III. U.S. CARRIERS' COSTS PROVIDE A REASONABLE SURROGATE FOR FOREIGN CARRIERS' TOTAL SERVICE LONG RUN INCREMENTAL COSTS.

The NPRM (¶¶ 31-32) rightly proposes that settlement rates properly should be set at the level of interconnection charges that would prevail in fully competitive markets. The NPRM (¶ 31) is also correct that the proper measure of economic cost for this purpose is total service long run incremental cost ("TSLRIC"). Such pricing is necessary to encourage efficiency and to prevent competitive distortions in the U.S. international telecommunications market. AT&T fully agrees that reducing settlement rates to this cost-based level should be the Commission's overall policy objective, and for this reason supports the adoption in this proceeding of benchmark rates that would most encourage carriers in all countries to reach these even lower levels as rapidly as possible.

Pricing settlement rates at TSLRIC would mean that U.S. carriers would pay only for the switching, signaling and transport elements used in foreign termination services, including depreciation and a return on capital. Provided the allocation of common costs is carefully controlled, TSLRIC would eliminate all subsidy payments to foreign carriers. But to ensure that these subsidies are not recreated in another guise, network access charges in the foreign country should be included in settlement rates only where they are levied on a non-discriminatory basis and, if above-cost, only where they are paid to non-affiliate entities.

The immediate use for TSLRIC should be in setting the bottom of the benchmark ranges and in establishing market entry conditions. Until the TSLRIC of terminating U.S. international services in each country is determined, or a cost-proxy model to estimate these costs is developed, U.S. carrier average cost data provides the Commission with a generous surrogate for such costs. Moreover, foreign carriers wishing to challenge the application of this surrogate measure would always be entitled to demonstrate that their TSLRIC termination costs were in excess of this level.

1. <u>TSLRIC is the Proper Measure of Cost for Settlement Rates.</u>

AT&T fully supports the NPRM's conclusion (¶ 31) that the pricing of international termination services should replicate the prices that would prevail in competitive markets. As the NPRM (¶ 32) explains, prices in competitive markets are determined by and driven toward forward-looking, long run incremental costs.[33] Five former Chief Economists of the Antitrust Division of the U.S. Department of Justice have recently explained:

> "Prices based on forward-looking costs give the right signals to both producers and consumers to ensure the efficient use of resources. This has long been recognized by professional economists and has been an informing principle of antitrust and regulatory policy."[34]

The proper time horizon is the long run, when all costs become variable, because entry decisions in competitive markets are based on long run costs. Forward looking long run incremental pricing includes not only operating expenses, but also "a depreciation rate that reflects the true changes in economic value of an asset and a cost of

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33 Long run incremental cost includes all costs an efficient supplier would consider in deciding whether to provide the additional quantities of service. *See American Tel & Tel. Co.,* 55 F.C.C. 2d 224, 231 n.18 (1975).

34 Letter dated Dec. 2, 1996 to The Honorable Reed E. Hundt, Chairman, Federal Communications Commission, from Bruce Owen, Lawrence J. White, Frederick R. Warren-Boulton, Bobby Willig and Janusz A. Ordover.

capital that appropriately reflects the risks incurred by an investor."[35] The appropriate measure is "total service" long run incremental cost, or its "element" variant, total element long-run incremental cost ("TELRIC"), because this recognizes that the facilities in question may be used for other purposes in addition to the termination of international calls.[36]

As the Commission concluded in establishing its network element pricing rules, "[a]dopting a pricing methodology based on forward-looking, economic costs best replicates, to the extent possible, the conditions of a competitive market."[37] As a result, "the requesting carrier [is allowed to] produce efficiently and to compete effectively, which should drive retail prices to their competitive levels." The Commission's further conclusion in the *Interconnection Order* that such a methodology "reduces the ability of an incumbent [carrier] to engage in anticompetitive behavior" is also fully applicable to the

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[35] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between the Local Exchange Providers and Commercial Radio Service Providers*, CC Docket 96-98 and 95-185, First Report and Order (released Aug. 8, 1996) ("*Interconnection Order*"), at ¶ 703.

[36] TSLRIC takes account of all of the additional costs that an efficient supplier would incur to supply all of the output of the relevant network element that is demanded by all uses and users of that element, assuming that the supplier continued to provide its other network elements, services and functionalities.

[37] *Id.* at ¶ 679. The UK regulator, OFTEL, has reached a similar conclusion. OFTEL has proposed to move to a system of interconnection prices for the 1997-2001 period that would "[c]hange the cost base for interconnection charges from fully allocated historical costs to long run incremental costs - better reflecting the basis on which commercial businesses in competitive markets make investment decisions and thus providing the industry with more appropriate price signals." *Network Charges from 1997*, OFTEL Consultative Document, Dec. 1996, at 5.

U.S. international market.[38] As shown in Sections VI and VII below, by requiring that international termination services be priced at their economic cost, the use of TSLRIC would effectively preclude the market distortions that may result from the provision of switched services over resold international private lines ("IPLs") or from facilities-based U.S. market entry by foreign carriers.

These pro-competitive objectives would not be served if foreign carriers were able to corrupt the TSLRIC standard by adding inappropriate "common," "shared" or "residual" costs. To ensure that this does not occur, the Commission should follow the conclusions it reached concerning the application of this methodology in the *Interconnection Order*.[39] Specifically, only the forward-looking costs of providing international termination services should be included in TSLRIC, and historic book or embedded costs should not be used.[40] Costs should be based on the most efficient technology deployed in the foreign carrier's international termination services, and should be attributed on a cost-causative basis.[41] For this reason, retailing costs, which are not attributable to international termination services, should not be included.[42] Above all, the foreign carrier should always carry the burden of proving the nature and magnitude of its costs, as it has greater access to the necessary information.[43]

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38 *Interconnection Order*, at ¶ 703.

39 *See Interconnection Order* at ¶¶ 690-711.

40 *Id.* at ¶ 705.

41 *Id.* at ¶¶ 685, 690-691.

42 *Id.* at ¶ 691.

43 *Id.* at ¶ 680.

The NPRM (¶ 32) also properly suggests that international termination services should provide a reasonable contribution to common costs. In fact, if TSLRIC is applied properly, the large majority of costs should be causally attributable and common costs should be relatively few in number. But to constrain foreign carriers' incentives to manipulate the allocation of any common costs, the Commission should allocate common costs as a fixed percentage mark-up over directly-attributable forward-looking costs.[44] As a further precaution, costs should not exceed the stand-alone costs of international termination services, which are the forward-looking costs that an efficient entrant would incur in providing them.[45]

2. Foreign Access Charges Should be Competitively Neutral.

The questions raised by the NPRM (¶ 52) concerning the proper treatment of access charges paid to local carriers highlight an important emerging issue. Some countries may respond to the Commission's efforts to reduce settlement rates by seeking to establish an alternative source of subsidy by U.S. and other foreign consumers in the form of network access charges. Indeed, two countries, Chile and Mexico, have already done so. Although competitively neutral, non-excessive network access charges are properly included in settlement costs, the Commission should not allow the inclusion of

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[44] *Id.* at ¶ 696 (identifying this approach as one of two "reasonable allocation methods" for common costs). This approach would be much easier to administer than the second method identified in the *Interconnection Order*, under which those network elements that are most difficult to replicate would carry a smaller share of common costs. *See id.*

[45] *Id.* at ¶ 698 ("No price higher than stand-alone cost could be sustained in a market from which entry barriers were completely absent.").

any access charge that discriminates between carriers or classes of customers, or any above-cost charges paid to affiliates.

Some of the potential problems with access charges are demonstrated by those introduced by Chile in 1995 and by Mexico last year. The Chilean access charge was designed to preserve subsidies to the Chilean local monopoly carrier from non-Chilean international callers by imposing dramatically higher rates on Chile-inbound international calls than the rates imposed on Chile-outbound and domestic long-distance calls. The access charge forms a floor for settlement rate negotiations between U.S. carriers and Chilean international carriers, which must pay the inbound access charge to CTC, the Chilean local monopolist. In Mexico, the access charge on inbound international calls is a percentage of the settlement rate and is again far in excess of the access charge on domestically-originated calls.[46]

In each case, these charges are a vehicle to replace the otherwise declining international settlement subsidy. Unless the Commission makes clear that it will not tolerate the imposition of these new subsidies on U.S. consumers, other countries may seek to replace their subsidy losses from lower settlement revenues by following the example set by these two countries. To forestall any such attempt to end-run the Commission's actions to remove subsidy payments from settlement rates, access charges

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[46] *See* Mexican Secretariat of Communications and Transportation, Administrative Order By Which The Secretariat Of Communications And Transportation Establishes the Rate Regulation Applicable To Interconnection Services By Public Telecommunications Networks Authorized To Provide Long Distance Services, Apr. 26, 1996, at 4.

should be included in settlement costs only if they give equal treatment to all carriers, irrespective of national origin, and to all types of domestic and international traffic, including local, toll, and inbound and outbound international calls. Requiring such nondiscriminatory treatment will help ensure that foreign carriers and consumers are not required to carry unreasonable charges. The Commission should also disallow any above-cost access charges paid to affiliated entities, as these are merely internal transfer payments.

3. U.S. Carriers' Average Cost Data Provide a Generous Surrogate for Foreign Carriers' TSLRIC Data.

It is well-settled that where, as here, no precise data are currently available, the Commission may rely on reasonable surrogates for carrier charges.[47] Because the "paradigmatic scope of agency expertise is often pragmatically circumscribed . . . by the need to respond to complex, growing regulatory problems within a reasonable period of time,"[48] the "fact that an agency's decision . . . rests on a set of evidentiary facts less desirable or complete than one which would exist in some regulatory utopia does not alter" the reasonableness of the agency's decision.[49] Here, ample evidence exists to support the reasonableness of the Commission's use of U.S. data as a surrogate for the costs of foreign country termination.

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47 *NARUC v. FCC*, 737 F.2d 1095, 1140 (D.C. Cir. 1984).

48 *Id.* at 1124.

49 *Id.* at 1140. *See also ICORE, Inc. v. FCC*, 985 F.2d 1075, 1080 (D.C. Cir. 1992) (although "the absence of cost data" limited the FCC's ability to `implement an absolutely accurate surrogate,'" the parties' detailed responses nevertheless "provide a substantial basis for the Commission decision").

Until all foreign carriers establish their TSLRIC of terminating U.S. international services, the Commission must calculate these termination costs under an alternative method. The Commission must establish these costs both to set the lower end of the benchmark ranges and to ensure that foreign carriers' provision of switched services over international private lines or of outbound switched services will not lead to competitive distortions in the U.S. international market. As explained above, the Commission may use a reasonable surrogate for this purpose.

AT&T strongly supports the NPRM's proposal (¶ 50) to use U.S. carrier data to establish the surrogate for foreign carriers' incremental costs. U.S. carrier data provide a reasonable proxy for this purpose because there are no material differences between the costs of U.S. and foreign carriers for the termination of international calls.[50] Rather, any cost differences that do exist should result in foreign carriers having lower costs than U.S. carriers.

The reasons for these similarities in costs are straightforward. The same network components are used by U.S. and foreign carriers for the termination of international calls: international transmission; international switching; and domestic transport and termination. For the first of these three components, both U.S. and foreign carriers generally acquire undersea cable capacity for international transmission under similar consortium cable system agreements and satellite capacity from independent, satellite providers. Both cable and satellite capacity are obtained under tariff or under

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[50] *See* NPRM ¶ 52 (requesting comment on the existence and extent of any such differences).

arms-length contractually negotiated terms. As shown in Attachment D, foreign carriers' satellite transmission costs may even be significantly lower than U.S. satellite transmission costs because of their ability to purchase directly from Intelsat, while U.S. carriers are required to use Comsat as an intermediary.[51]

U.S. and foreign carriers' costs for the second network component of international termination services, international switching, are unlikely to differ. Switching equipment is purchased by both U.S. and foreign carriers from the same equipment providers in a competitive, global market.[52]

To the extent that costs may differ for the third network component of international termination services, domestic transport and termination, vertically integrated foreign carriers that own and operate national networks may experience lower costs than U.S. interexchange companies. U.S. international carriers pay access charges to the Regional Bell companies and to independent telephone companies for the completion of international calls at rates that are significantly higher than the long run incremental costs

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[51] *See, e.g., Comsat Study - Implementation of Section 505 of the International Maritime Satellite Telecommunications Act*, 77 F.C.C. 2d 564, 614 (1980). A country's geographic location does not affect satellite transmission costs, which are insensitive to distance.

[52] The NPRM (¶ 37 & n.50) cites information published by the ITU indicating that international gateway costs vary with the level of digital facilities. However, the ITU data was not limited to the most efficient technologies deployed in each country, as TSLRIC requires, but rather took an embedded cost approach. As digital switching is the least cost technology for this purpose in all countries, international switching costs should be based only on digital technology, rather than on the mix of digital and analog technologies used by the ITU.

of termination incurred by the local companies.[53] Where a foreign carrier operates as a vertically integrated provider of local and international services in its market, the long run incremental costs incurred for the domestic transport and termination component of international termination services would more closely resemble the lower costs incurred by U.S. local companies, rather than the costs incurred by U.S. international carriers based on interstate access charges.

For these reasons, the Commission should conclude that the long run incremental costs incurred by foreign carriers for the three network components for international termination services are certainly no higher than the long run incremental costs incurred by U.S. carriers.

As the NPRM (¶ 51) notes, AT&T has submitted its estimated average worldwide network termination cost of $0.075 per minute for inbound international calls.[54] This estimate is based on a weighted average of costs for the international transmission, international switching, and domestic transport and termination components of international termination services, which are described in Attachment E. Because this estimate is based on average costs, it exceeds the cost that would result from a forward-

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53 *See, e.g.*, Access Charge Reform, CC Docket No. 96-262, Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry, Comments of AT&T Corp., (filed Jan. 29, 1997), at 13 (estimating that annual interstate access charges exceed forward-looking economic cost by more than $10.6 billion).

54 Letter dated Dec. 16, 1995 to Donald Gips, Chief, International Bureau, Federal Communications Commission, from R. Gerald Salemme, Vice-President - Government Affairs, AT&T.

looking long run incremental cost methodology.[55] Thus, if the long run incremental costs incurred by foreign carriers are no higher than the long run incremental costs incurred by U.S. carriers, it follows that such costs are certainly less than a U.S. carrier's average costs of $0.075 per minute. This figure accordingly provides a generous proxy for such costs in the absence of actual TSLRIC information from foreign carriers.[56]

IV. THE COMMISSION SHOULD ESTABLISH EXPEDITED BENCHMARK ENFORCEMENT PROCEDURES AND PRESCRIBE RATES PURSUANT TO CARRIER COMPLAINT.

The single lesson to be drawn from the 1992 benchmarks is that timely compliance with new benchmarks by foreign carriers will be obtained only through the active exercise of the Commission's prescriptive powers. As shown in Section I, benchmark settlement rates that merely provide aspirational goals will have only muted impact. Where foreign carriers have not met transition or benchmark requirements, the

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55 As the NPRM (¶ 51) observes, the AT&T estimate includes contributions to common costs. The local distribution component reflects the average price paid by AT&T to local exchange companies to terminate traffic.

56 Another possible surrogate could be obtained by calculating foreign carriers' TSLRIC by using a forward-looking economic cost computer model. An example is the Hatfield model, which can accurately measure the forward-looking economic costs of serving the total demand for U.S. domestic interexchange access. The Commission has concluded that "these models appear to offer a method of estimating the cost of network elements on a forward-looking basis that is practical to implement and allows . . . the ability to examine the assumptions and parameters that go into the cost estimates." *Interconnection Order* at ¶ 835. The Commission staff has also conducted an analysis of forward-looking economic cost computer models. *See The Use of Computer Models for Estimating Forward-Looking Economic Costs*, FCC Staff Analysis, Jan. 9, 1997. Until such a model has been developed to produce country-specific TSLRIC figures for termination services and evaluated by the Commission, however, it cannot provide an immediate alternative to the use of U.S. carrier data.

Commission should exercise its prescription authority upon U.S. carrier complaints listing such countries and under an expedited schedule.

1. **The Only "Safe Harbor" Should be the Adoption of Benchmark Rates, or of Interim Proportionate Steps Toward These Rates During the Transition Period.**

The primary consideration in evaluating the necessity of enforcement action by the Commission should be whether the foreign carrier has brought its settlement rates within the benchmarks, including conformity with the 1992 benchmarks and the adoption of equal annual interim steps toward the new benchmarks during the transition period. Only the achievement of these benchmark levels should provide a "safe harbor" against potential Commission enforcement following a carrier complaint. While the Commission may prioritize its actions in response to multiple complaints by also considering countries' commitments to competitive reform and the size of their settlement payment (*see* NPRM ¶ 87), its overriding concern should be whether the foreign carrier has adopted the required interim or benchmark rates and the status of negotiations to achieve that objective.

2. **Carrier Complaint Should Provide the Primary Impetus for Enforcement.**

The most effective means to ensure that the Commission's enforcement activities address those countries that are most resistant to reducing rates is for the Commission to take action following complaints filed by U.S. carriers. Any such complaint should be required to demonstrate only that the existing or proposed settlement rate is above the benchmark level (or the required transition level) and that the foreign carrier has refused to lower the accounting rate to the benchmark level.

The Commission should establish an expedited process to address carrier complaints. The foreign carrier, and any other interested person, should have 28 days from the Commission's public notice of the complaint to file comments in opposition to the complaint. The complaining U.S. carrier should have 10 days in which to file reply comments in support of the complaint. The Commission should then issue a decision in the matter, including the prescription of a settlement rate to be paid by all U.S. carriers if the Commission concludes that such a prescription was justified. In order to ensure an expedited process, the Commission should also consider establishing a timeframe for its own decisionmaking.

As noted above, in prescribing a rate where the foreign carrier has failed to meet the required transition rate, the Commission should direct all U.S. carriers to settle at the relevant benchmark rate. Where the foreign carrier has failed to meet benchmarks, it should direct settlement rates paid by U.S. carriers to be below the top of the relevant benchmark range. Otherwise, foreign carriers may simply delay compliance until the Commission exercises its prescriptive powers.[57]

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[57] In addition to the government communications proposed by the NPRM (¶ 88), the Commission should take steps to ensure that foreign carriers are fully informed of the new benchmarks and the enforcement process. All U.S. carriers should therefore be encouraged to provide copies of the Commission Order in this proceeding to their foreign correspondents.

V. SETTLEMENT RATES SHOULD BE SET AT TSLRIC PRIOR TO AUTHORIZATION OF INBOUND SWITCHED SERVICES OVER INTERNATIONAL PRIVATE LINES.

The NPRM (¶¶ 11, 75) recognizes the severe competitive harm that may result if foreign carriers are able to avoid paying settlement rates on their U.S.-inbound switched traffic by sending this traffic over international private lines ("IPLs"), and at the same time continue to receive above-cost settlement rates on U.S.-outbound traffic to their countries. While AT&T supports the NPRM's initiative (¶ 81) to use settlement rates to prevent such "one-way by-pass" in the future, merely requiring settlement rates to be within the benchmark range as a condition of authorizing switched services over IPLs, as the NPRM proposes (¶ 82), would not provide a sufficient safeguard. All foreign carriers should achieve benchmark rates anyway within a short period of time of the Commission's Order in this proceeding. AT&T believes that the settlements process can be an effective substitute for the equivalency test in redressing this type of competitive harm only if the required settlement rate removes all incentive to engage in one-way by-pass. Reliance upon regulatory monitoring to identify market distortions resulting from one-way by-pass, as set forth in the NPRM (¶ 83), would not be effective and would impose highly burdensome reporting requirements on U.S. carriers.

The Commission should rather adopt the NPRM's alternate proposal (¶ 84) to require that settlement rates be set at the bottom of the benchmark range -- i.e., at TSLRIC -- before authorizing the provision of switched services over IPLs between the relevant country and the United States. Otherwise, the Commission should retain a meaningful equivalency test.[58]

1. Requiring Settlement Rates To Be Within the Benchmark Range Would Not Remove the Incentive for One-Way By-pass.

Since first approving the provision of switched services over international private lines to countries meeting equivalency requirements, the Commission has consistently sought to prevent one-way by-pass.[59] The NPRM (¶ 11) reaffirms the serious potential harm to U.S. carriers and consumers that would result if foreign carriers are allowed to exploit their above-cost accounting rates in this way. By limiting these services to countries that "afford[] resale opportunities equivalent to those available under U.S. law,"[60] the Commission presently ensures that "any short-run traffic diversions will fall evenly on both correspondents."[61]

Allowing carriers from all countries to provide these services on the condition that their settlement rates are within the benchmark ranges, as the NPRM (¶ 82)

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58 The Commission should apply the cost-based settlement rate requirement for routes on which switched services are provided over IPLs to all further authorizations for these services (*see* NPRM ¶ 85), including all pending applications, but not to those routes where the Commission has already found that the relevant country meets the requirements of the equivalency test.

59 *See, e.g., Regulation of International Accounting Rates*, 7 FCC Rcd. 559, 561 (1990)("*International resale Order*")("'one-way' resale would be detrimental to the U.S. public interest"); *ACC Global Corp.*, 9 FCC Rcd. 6240, 6242-43 (1994); *Market Entry and regulation of Foreign-affiliated Entities*, 11 FCC Rcd. 3873, 3924 (1995) ("permitting unilateral evasion of the settlements process would exacerbate the U.S. settlements deficit and ultimately increase the burden on U.S. ratepayers"); *Cable & Wireless, Inc*, 11 FCC Rcd. 1766, 1767 (1996).

60 47 CFR Sect. 63.01(k)(5)(1995).

61 *International Resale Order*, 7 FCC Rcd. at 561.

proposes, would provide a poor substitute for these existing protections. Foreign carriers would still have a strong incentive to send their traffic to the U.S. over IPLs, while continuing to collect above-cost benchmark settlement rates on U.S.-originated traffic. The significant margin between the cost-based termination rates they would be able to obtain for their U.S.-bound traffic -- under 7.5 cents, as shown in Section III -- and the proposed benchmark levels of 15.4 cents for upper income countries, 19.1 cents for middle income countries and 23.4 cents for low income countries would provide significant profit margins for foreign carriers on every minute delivered to the U.S. If this approach is adopted by the Commission, retention of the present equivalency test would also be necessary in order to protect against the widespread use of one-way by-pass that would inevitably result from these incentives.

By contrast, a requirement that settlement rates be set at the <u>bottom</u> of the benchmark range -- i.e., at TSLRIC, or a surrogate cost number -- before switched services could be provided over IPLs would remove the incentive for foreign carriers to engage in one-way by-pass. As the NPRM (¶ 83) correctly concludes, "[b]y ordering all carriers to pay settlement rates at the lower end of the benchmark range for switched traffic, the Commission would eliminate the financial harm from above-cost settlement rates that makes competitive harm possible."

Because a requirement that settlement rates be at TSLRIC would effectively protect against one-way by-pass, all countries meeting that requirement, whether or not they allow the termination of switched services over IPLs, could be given U.S. market entry to provide these services without any competitive harm to U.S. carriers and consumers. With a TSLRIC safeguard, it would no longer be necessary to limit these services to countries meeting the equivalency test.

However, the requirement for TSLRIC should apply to all countries on a non-discriminatory basis. There should be no need to preserve the equivalency test unnecessarily in the form of the suggested presumption exempting countries from this safeguard if they have "meaningful competition" (NPRM ¶ 85). In the event that effective competition does emerge in some markets one day and "constrain[]" (NPRM ¶ 75) the ability of foreign carriers to collect above-cost settlement rates, the requirement for TSLRIC would merely become superfluous as those countries' rates were reduced to cost-based levels.

2. **Regulatory Monitoring Would Not Provide Adequate Protection.**

Implicit in the NPRM's proposal to address one-way resale by requiring settlement rates to be set at benchmark levels is the assumption that any subsequent competitive distortions could always be detected on a timely basis. Thus, the NPRM suggests (¶ 83) that monitoring activities by the Commission would identify any changes in inbound-outbound ratios of international switched minutes following the authorization of switched services over IPLs.

The only existing information received by the Commission that would reveal such shifts in traffic is through the Section 43.61 reporting process. Preliminary information for these annual revenue and traffic reports is submitted seven months after the end of the calendar year, and final information is submitted three months later.[62] Thus, reliance upon this existing reporting mechanism for the identification of one-way by-pass would delay any remedial relief by at least these periods. Conversely, the introduction of additional reporting requirements by the Commission would impose a major compliance burden upon U.S. carriers and could require the disclosure of competitively sensitive information. Even if more frequent reports covering all international switched traffic were required only for routes on which switched services over IPLs were authorized, the additional reporting burden would still be considerable in view of the probable widespread use of these services by foreign carriers once the equivalency test was removed.[63]

A further difficulty with any attempt to identify one-way by-pass from Section 43.61 traffic reports is that it would be impossible to determine the specific cause of any shift in the inbound-outbound traffic ratio. As the NPRM notes (¶ 12 & n.15), call-back is already leading to noticeable shifts in traffic ratios on some routes and is likely to

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[62] *See* 47 C.F.R. § 43.61 (1995). The preliminary version of the report is generally made available during the fourth quarter (i.e., more than nine months after the end of the relevant calendar year).

[63] The poor compliance with the Commission's existing traffic reporting requirement for switched services provided over IPLs also instills no confidence that any additional reporting requirement would yield useful information. The Commission requires carriers authorized to provide these services to file traffic reports every six months during the initial three year period after an equivalency finding. *See fONOROLA Corp.*, 9 FCC Rcd. 4066, 4070 (1994) (establishing the filing requirement for the U.S.-Canada route); *ACC Global Corp.*, 9 FCC Rcd. at 6269 (U.S.-U.K. route); *Cable & Wireless, Inc.*, 11 FCC Rcd. at 1772 (U.S.-Sweden route). However, AT&T's research indicates that only 13 of 87 required reports were filed for the U.S.-Canada route in 1994-95, only 18 of 100 required reports were filed for the U.S.-U.K. route in 1994-96, and only 6 of 16 required reports were filed for the U.S.-Sweden route in 1996.

be used more widely in the future.[64] Besides the difficulty of distinguishing traffic shifts caused by one-way by-pass from those resulting from other market changes, the Commission would need to determine whether to apply a "zero tolerance" policy toward one-way by-pass or whether to penalize only significant variances in traffic ratios. For these reasons, AT&T believes that any attempt to address one-way by-pass through remedial regulatory measures would be a fruitless and overly burdensome exercise. The Commission should instead eradicate the root cause of one-way by-pass by requiring that settlement rates on the relevant route to be at cost prior to any authorization of these services.

VI. SETTLEMENT RATES SHOULD BE SET AT TSLRIC TO PREVENT COMPETITIVE DISTORTION WHEN FOREIGN CARRIERS PROVIDE U.S.-OUTBOUND FACILITIES-BASED AND SWITCHED RESALE SERVICES TO AFFILIATED MARKETS.

Equally severe is the potential competitive harm from above-cost settlement rates when foreign carriers enter the U.S. market to provide switched facilities-based and resale services on routes to affiliated markets. Foreign carriers have strong incentives to enter the U.S. market in order to earn additional profits at both ends of the international route and to exploit their significant strategic pricing advantage in competing

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[64] An alternative approach adopted by the UK of requiring each carrier to maintain its IPL switched traffic to and from each country within a specific inbound-outbound ratio appears equally flawed. Because a carrier cannot control its inbound traffic, it would be difficult for carriers to meet required traffic ratios without either extended reporting periods or through the extensive use of estimates and adjustments that would greatly increase the complexity of the reports and the difficulty of enforcement. Substantial administrative resources would be required to review reports by multiple carriers on large numbers of routes. While incentives to under-report or to misreport under such a system would be strong, such misbehavior would be hard to detect.

with U.S. carriers that must pay them above-cost settlement rates. To the extent that the foreign carriers' settlement rates exceed economic cost, their costs of providing U.S.-outbound services to their affiliated markets are lower than the costs incurred by U.S. carriers.[65] They can therefore "price squeeze" U.S. carriers, in addition to exploiting their control of foreign bottleneck facilities for discriminatory purposes.

Because the proposed benchmark ranges still exceed economic cost by significant margins, the NPRM's proposal (¶ 76) to condition international facilities-based authorizations on conformity with the benchmarks would not remove these carriers' strategic pricing advantages. As the NPRM acknowledges (*id.*), a complete remedy requires settlement rates to be reduced "to the bottom of the range." Here again, rather than wait for market distortion to occur, the Commission should attack the root cause and remove foreign carriers' ability to engage in anticompetitive conduct by requiring that settlement rates to be set at cost as a condition of market entry.[66] To attempt to identify misconduct through regulatory monitoring, as the NPRM (¶¶ 76-77) proposes, would at least require the reimposition of regulation that the Commission has only recently removed as being unreasonably burdensome. As described below, the only viable alternative to requiring cost-based settlement rates is to continue to limit U.S. market entry for the

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65 The same facilities can also be used to provide inbound services and can result in the same by-pass concerns as inbound services provided over resold facilities.

66 Moreover, unless U.S. carriers have actual competitive opportunities abroad, foreign carriers that comply with this condition and are granted entry nevertheless will still obtain competitive marketing advantages unavailable to U.S. carriers.

provision of facilities-based and switched resale services to foreign carriers meeting the effective competitive opportunities test.[67]

1. Foreign Carriers Have Strong Incentives to Enter the U.S. International Services Market and to Engage in Anticompetitive Conduct.

AT&T believes that the NPRM (¶ 80) is mistaken in suggesting that foreign carriers would suffer an unacceptable "opportunity cost[]" of lost above-cost settlements payments if they entered the U.S. market in competition with U.S. carriers. In fact, through such market entry, foreign carriers would capture additional profits at both ends of the international route. Even a foreign carrier with a monopoly in its home market may obtain three additional potential sources of profit on international traffic to and from its home country by establishing an affiliate carrier in the U.S. market. First, as the above-cost settlement rate likely exceeds U.S. termination costs, through such an affiliate the foreign carrier may earn profits from terminating U.S.-inbound traffic. Second, to the extent that its U.S. collection rate exceeds costs, the foreign carrier may use its affiliate to earn profits on U.S.-outbound traffic. Third, by using its affiliate to lower price in the U.S. market, the foreign carrier may earn additional settlements revenue by stimulating additional U.S.-outbound traffic to its home market from all carriers.

In deferring a decision on GTE Telecom's application to resell international switched services to the Dominican Republic and Venezuela, the International Bureau

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[67] As with the provision of switched services over IPLs, the requirement for cost-based rates should apply to all further authorizations for the provision of switched services to affiliated markets, and to all applications to add circuits to already-authorized affiliated routes, including all pending applications (*see* NPRM ¶ 85).

recently acknowledged that a U.S. carrier affiliated with a foreign carrier with market power may have the incentive to stimulate increased above-cost settlements payments to its foreign affiliate by pricing U.S. services at or below cost.[68] The additional profits to be obtained by foreign carriers from their above-cost accounting rates when U.S. price reductions stimulate increased U.S.-outbound traffic volumes are further demonstrated by recent price changes on the U.S.-U.K. route. According to AT&T's estimates, both MCI and AT&T will lose revenues from MCI's recent consumer price reduction to $0.12 per minute on this route, which AT&T has also now introduced. However, BT, which terminates the large majority of U.S.-U.K. traffic, will earn additional revenues as a result of the increased settlement payments from the stimulated traffic volumes.

Unless foreign carriers participate in the U.S. market through affiliates, they can influence U.S. prices only indirectly, by reducing settlement rates -- which entail direct and immediate reductions in their profits. But through U.S. market entry, foreign carriers may stimulate traffic directly, without lowering accounting rates, by lowering U.S. market prices. Moreover, in setting their U.S. prices, foreign carriers have an unbeatable

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68 *GTE Telecom Inc.*, ITC-95-443, Order, Authorization and Certificate, (released Sept. 16, 1996), at ¶ 45. Significantly, the GTE application was for authority to provide switched resale services. The International Bureau concluded that GTE would "plausibl[y]" be motivated to price its U.S.-outbound resale services below cost in order to generate additional settlements payments from U.S. facilities-based carriers to its foreign affiliates. *Id.* Because foreign carriers entering the U.S. market to provide switched resale services on affiliated routes may be subject to similar motivations, the Commission should also require settlement rates to be at TSLRIC before authorizing the provision of switched resale services to affiliated markets.

cost advantage over all U.S. carriers. Although they may "pay" themselves the same nominal settlement rate as U.S. carriers, this is merely an internal transfer payment.

Consequently, foreign carriers entering the U.S. market are able to impose price squeezes on U.S. carriers, by cutting their U.S. prices potentially as low as the foreign carriers' TSLRICs of U.S. origination and foreign market termination.[69] Such conduct would harm competition by limiting the participation of existing carriers and by discouraging further market entry.[70]

2. The Burdens of Attempting to Address Competitive Distortion Through Regulation Require Continued Use of the ECO Test Unless Entry is Conditioned on Cost-Based Rates.

While apparently recognizing that requiring settlement rates to be at the bottom of the benchmark range (i.e., at cost) would prevent foreign carriers from leveraging these rates for anticompetitive purposes, the NPRM (¶ 76) proposes to

69 *C.f.*, *Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport,* 10 FCC Rcd. 6375, 6402 (1995) (Report and Order) ("While predation may be infrequent, under certain market conditions it may be a profitable strategy" (citing authorities)).

70 Beyond taking strategic pricing actions, foreign carriers, particularly in closed markets, may also use their control of the foreign end of the international circuit to engage in a wide range of discriminatory and exclusionary actions against their U.S. competitors. *See, e.g., Sprint Corp.*, 11 FCC Rcd. 1850, 1859-60 (1996) (describing potential forms of discrimination against U.S. carriers). The Commission should continue to require all U.S. carriers to observe the "no special concessions" undertaking and to enforce the requirements of its dominant carrier rules for quarterly traffic and revenue reports on all affiliated routes, prior authorization of circuit additions, and for the maintenance of records of the provisioning and maintenance of all facilities provided by the foreign affiliate. *See, e.g., Foreign Carrier Market Entry Order*, 11 FCC Rcd. at 3974-75. However, none of these requirements address strategic pricing behavior.

establish this entry condition only on routes where distortions of competition have occurred. The NPRM (¶ 77) then asks how the Commission should determine the existence of distortions and how its reporting system should be changed. But post-entry regulatory measures can do little to address competitive distortion without imposing compliance and enforcement burdens that the Commission has already found to be unacceptably burdensome.

No existing Commission regulation of the U.S. international services market would detect the anticompetitive pricing that may occur as a result of self-correspondency by the U.S. affiliates of foreign carriers. Furthermore, any new regulation to detect such pricing would, in effect, revive and apply even more broadly the requirement for the filing of cost support for tariffs that was, until recently, part of the Commission's regulation of dominant, foreign-affiliated carriers.[71] The Commission removed this requirement from its dominant carrier rules only fourteen months ago because it concluded that "the benefits derived from requiring the submission of such information are as a general rule outweighed by the burden imposed by this filing

[71] *See Telefonica Larga Distancia De Puerto Rico & LD Acquisition Corp.*, 8 FCC Rcd. 106, 112 (1992) ("While we recognize AT&T's concern that the above-cost component of accounting rates may be used by a foreign carrier to subsidize its affiliated U.S. carrier's competitive operations in the United States, this concern is addressed by our dominant carrier policies, which require that LD provide us with cost support for its tariffed international services"). Examination of such data, for example, would be required for the application of the price squeeze tests applied by the courts. *See, e.g.*, ABA Antitrust Section, Antitrust Law Developments (3d ed. 1992), 238-39.